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The Brussels-Frankfurt consensus: An answer to the wrong question

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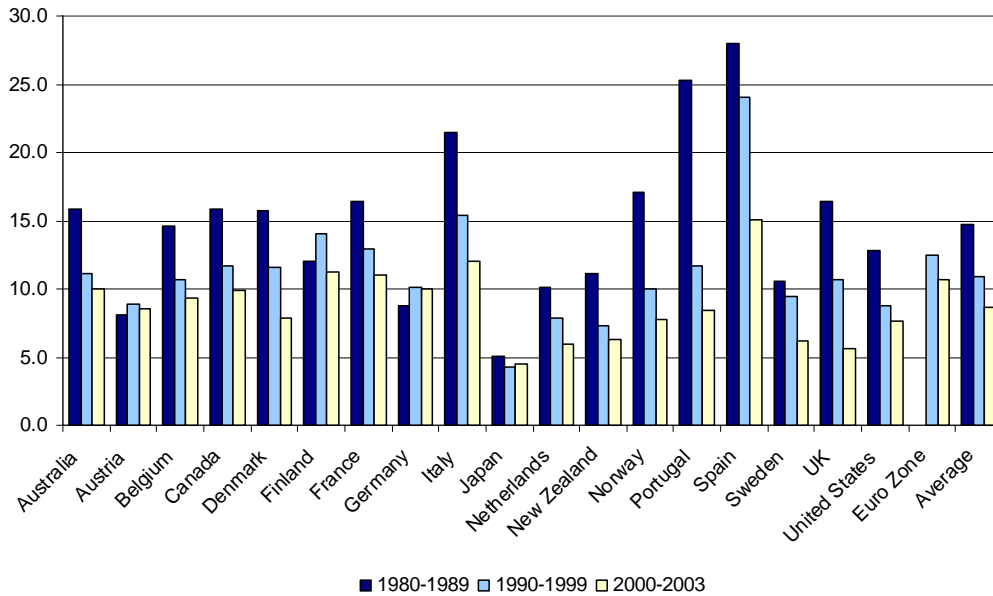
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1. Introduction

Figure 1 provides a graphical depiction of the Okun Misery Indexes (the sum of the inflation rate and unemployment rate) for the periods 1980-1989, 1990-1999, and 2000-2003 for selected countries (for which complete data is available) and the Euro Zone (post 1990) and the average of the sample shown. The average misery index has fallen from 14.7 per cent in the 1980s to its recent value of 8.6 per cent. The average unemployment rate corresponding to these misery indexes increased from 7.3 to 8.3 per cent, and subsequently declined to 6.4 per cent in 2000-2003.² By implication, the weight of inflation in the index decreased from 50 per cent in the eighties to about 25 per cent in recent times. Unemployment now constitutes by far the largest part of misery in the portrayed OECD countries.

Figure 1 Misery indexes (percent) for selected countries, 1980-89, 1990-99, and 2000-03.

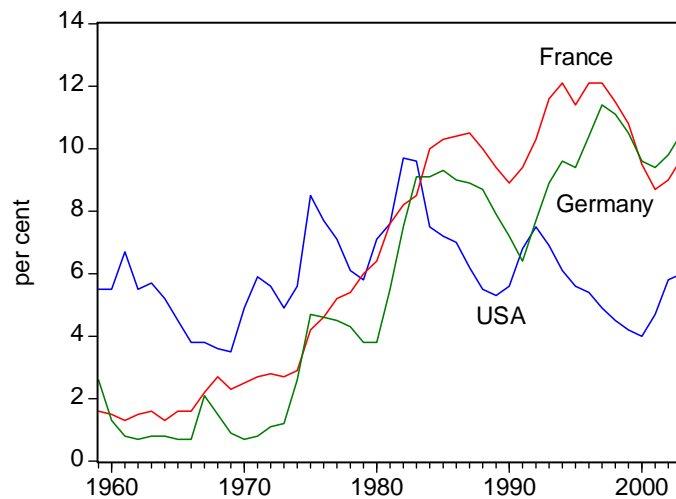


Source: OECD Main Economic Indicators.

Many countries (particularly in Europe) still experience near to double-digit unemployment rates. This is illustrated in Figure 2 which shows the post WWII unemployment experience in the US and in Europe, the latter represented here by France and Germany.

Against this background it is rather surprising that the on-going macroeconomic losses that arise from the persistent unemployment, not to mention the massive social and personal costs, are not considered by EU politicians to be the most compelling policy problem that needs their highest priority. Sadly, it appears that the politicians and policy-makers have the totally opposite construction of events. Unemployment is seen, at best, as an unfortunate and ephemeral consequence of policies that are required to maintain low inflation economies and are largely attributed to either rigidities (overly generous welfare and other regulations and out-of-touch unions) or to individual choice. This construction has allowed governments in Europe (and elsewhere throughout the OECD block) to abandon the goal of full employment and replace it with the diminished goal of full employability, which then generates a bevy of wasteful training programs that relentlessly churn the unemployed without enhancing their participation in paid employment. It is a policy agenda bereft of hope and its clear failure stands as an indictment of the governments that introduce it.

Figure 2 Unemployment rates in 'Europe' and the US, 1959–2003



Source: OECD Economic Outlook.

The underpinning of the bankrupt policy framework is dubbed in the influential Sapir *et al.* (2003: 41) Report as the 'Brussels-Frankfurt consensus' and represented as follows:

The maintenance of price stability - reflected in low rates of inflation - facilitates achieving higher rates of economic growth over the medium term and helps to reduce cyclical fluctuations. This shows up in a lower variability of output and inflation. In turn, sound public finances are necessary both to prevent imbalances in the policy mix, which negatively affect the variability of output and inflation, and also to contribute to national savings, thus helping to foster private investment and ultimately growth. The latter beneficial effect is magnified as low deficits and debt, by entailing a low interest burden, create the room for higher public investment, "productive" public spending and a low tax burden. Finally, the beneficial effects of price stability and fiscal discipline on economic performance reinforce each other in various ways. On the one hand, fiscal discipline supports the central bank in its task to maintain price stability. On the other hand, prudent monetary and fiscal policies avoid policy-induced shocks and their unfavourable impact on economic fluctuations while ensuring a higher room for manoeuvre to address other disturbances that increase cyclical instability.

The Sapir report is broadly sympathetic of the view underlying this consensus, although it stresses that some of the recommendations following from it should consider the possibility that shocks may be asymmetric, which implies that the policy 'rules' it espouses might be applied differently across countries to consider 'specific' circumstances.

The overwhelming priority of price stability has enormous implications for unemployment in that the latter has become an instrument of policy rather than a policy target. The use of a 'buffer stock' of unemployment to control inflation reflects the dominant 'faith' in the NAIRU (Non Accelerating Inflation Rate of Unemployment) construct. The adherents of this 'faith' have largely been dismissed these 'costs' as adjustments towards equilibrium and therefore a transitory phenomenon without long-term relevance. Implicit in the Brussels-Frankfurt consensus is the view that there is no relevant sustainable trade-off between inflation and unemployment (Sapir *et al.*, 2003: 44-5). In other words, unemployment will converge to the NAIRU and needs little separate policy action. This view also underlies the highly influential OECD Jobs Study (OECD, 1994) which has shaped labour market policies in many OECD countries. For the EU-countries the Jobs Study and its underlying 'faith' became especially important after the Luxembourg Summit of 1997. The European

Employment Strategy which was implemented at the Summit is largely modelled along the lines set out by the OECD Jobs Study (Dostal, 2004).

Our view is quite different and much more in line with that of Modigliani, who introduced the term NAIRU to the economics profession (Modigliani and Papademos, 1975). Modigliani (2000: 3) recently argued that:

Unemployment is primarily due to *lack of aggregate demand*. This is mainly the outcome of erroneous macroeconomic policies... [the decisions of Central Banks] ... inspired by an obsessive fear of inflation, ... coupled with a benign neglect for unemployment ... have resulted in systematically over tight monetary policy decisions, apparently based on an objectionable use of the so-called NAIRU approach. The contractive effects of these policies have been reinforced by common, very tight fiscal policies (emphasis in original)

We would emphasise that one of the outcomes of the governments adopting the ‘ideology’ of inflation control via interest rate policy has been their failure to use fiscal policy in appropriate ways to ensure there are enough jobs created in their economies. We will also argue that the Brussels-Frankfurt consensus has also led to a narrowing of ‘acceptable’ monetary policy activity such that foreign exchange operations, which may have been previously necessary to maintain competitive currency values has been abandoned.

In the light of these policy deficiencies, we identify two major policy challenges that make the Brussels-Frankfurt consensus unsustainable. First, by ‘artificially constraining’ European governments to eschew public deficits, policy makers have created a situation where desired net savings in Euro-denominated financial assets by the private non-government sector is unable to be achieved and the result is lack of spending, sluggish production and entrenched unemployment. Second, the European Central Bank (ECB) is reluctant to provide the appropriate underpinning to European exporters through direct foreign currency market intervention because it has an ideological objection to building stores of \$US. The result is that the Euro is overvalued and exporters cannot achieve the necessary growth that is required to boost the domestic economies.

From our perspective it is obvious that the Brussels-Frankfurt consensus is an answer to the wrong question. The focus should not be on inflation, but on unemployment. Moreover, it should be recognised that contractionary policies with the aim of containing inflation can have very harmful effects on both unemployment and economic growth. We do not support the use of a ‘buffer stock’ of unemployed to maintain inflation targets as being an acceptable policy in modern democracies. It violates the human rights of those who are the victims of this policy.

The aim of this paper is threefold. First, we will analyse the background to the NAIRU-approach and the Brussels-Frankfurt consensus and trace its rise to the dominant position in European policy through the OECD Jobs Study, the European Employment Study, the Maastricht criteria and the Stability and Growth Pact (SGP). Second, we challenge the basis of this dominant paradigm in conceptual terms emphasising that European governments have abandoned full employment in favour of the diminished goal of full employability. Third, we will argue that key components of the Consensus are not in accord with the data. Our argument is organised as follows. Section 2 outlines the background to the macroeconomic policy debate and the attitudes towards unemployment against which Job Study was developed in the early 1990’s. We present in Section 3 some evidence, partly referring to our earlier work, to demonstrate the deficiencies that we see in the NAIRU-approach that has the European policy framework in its vice-like grip. In Section 4 we argue that the ideology underpinning the OECD Jobs Study has dominated the way policy makers have constructed the problem of unemployment and led to the implementation of active labour market policies

which emphasise supply-side factors but fail to enhance paid employment opportunities. We show how these views have shaped and driven the European Employment Strategy. In Section 5 we review the various arguments which have been presented in the literature against the Stability and Growth Pact. Section 6 presents a more fundamental critique of the various claims that are implied by the Brussels-Frankfurt consensus. Concluding remarks follow.

2. The European debate on macroeconomic policy and inflation

The oil crises in the early and late 1970s had a very different impact on the economies of both sides of the Atlantic, as can be seen from Figure 2. It seems plausible to us that these divergent economic developments were instrumental in shaping the debates about unemployment that took rather different direction in Europe relative to the way the debate unfolded in the US. In the US, the rational expectations revolution dominated the economic debate with New Classical economics emerging out of it as a popular framework. Accordingly, unemployment was analysed from the perspective of intertemporal substitution and real business cycle theory, all of which contributed to a denial of the concept of involuntary unemployment. This view was challenged by New Keynesians who sought to found the existence of involuntary unemployment in an explanation of wage rigidities and coordination failures. Whatever, by the 1990s, the focus of the US macroeconomic policy debate was on inflation rather than unemployment (Chang, 1997).

In Europe, New Classical economics never really played a serious role in the academic debate with Minford as a notable exception. Instead, there were two major influences. First, French speaking economists Malinvaud and Drèze led the disequilibrium approach. Second, the English economists such as Layard and Nickell developed an explanation of unemployment persistence within models of wage and price setting behaviour under the rubric of the ‘battle between mark-ups’. The latter view, with the NAIRU construct and all its attendant policy implications at centre stage, became dominant in the European macroeconomic policy debate.

2.1 Disequilibrium Economics

The seeds for the quantity rationing approach were planted by Patinkin, Clower, and Leijonhufvud. Barro and Grossman (1971: 84) extended “the Patinkin and Clower analysis of a depressed economy ... to develop a generalised analysis of both booms and depressions as disequilibrium phenomena.”

Although their analysis attracted a lot of attention, it did not gain any substantial foothold in the American economic debate. The main reason follows from the almost universal recognition of the *ad hoc* assumption of price rigidities. Howitt (1977: 124-5) offers the following insight:

The substantive shortcomings ... are generally those of the state of knowledge itself. ... First the treatment of wage and price dynamics is deficient. ... [Second the analysis] does not present a satisfactory account of the process of exchange.

In reaction to that critique, US economists, sympathetic with the notion of involuntary unemployment, sought to provide a rationale for price rigidities that was consistent with maximising microeconomic postulates. This approach became known as the New Keynesian paradigm.

It was left to some European economists to pick up the baton. The disequilibrium tradition was strongly advocated by Malinvaud and many, mainly French speaking, economists followed his lead (see De Vroey, 2004, part IV).

In his first book, Malinvaud (1977) introduces the famous distinction between three regimes, with the polar cases of Classical and Keynesian unemployment as the most relevant for our

analysis. He notes that Keynes uses the word ‘classical’ in two different meanings, which induces Malinvaud to distinguish between a Walrasian equilibrium, where all markets clear, and a Classical view in which a reduction in the wage rate could reduce unemployment. He emphasises that the latter often relies on a partial equilibrium on the labour market. However, as he states in his opening sentence (1977: 1):

... the term *involuntary* unemployment makes it obvious from the start that the labour market is one in which supply exceeds demand. Suppliers are therefore rationed in the sense that some of them do not find jobs. Hence unemployment theory must be closely connected with the theory of rationing.

In spite of refinements to his initial model, Malinvaud’s (1980, 1984) theory never gained wide acceptance among the profession at any level. Efforts to incorporate his approach in the European research project, the ‘European Unemployment Program’, coordinated by Drèze and Bean had very limited success. In that program, financed by the EC, participants from ten European countries met to agree on a common theoretical specification of a model to explain unemployment and to estimate that model for their own countries. The central model is quite eclectic, and some authors interpreted it quite liberally when applying it to their own country (see the results presented in Drèze and Bean, 1990).³

Drèze and Bean (1990: 59, 60) summarise the (interesting) conclusions of the Program as:

The main and perhaps singular determinant of output growth in the 1980s in Europe has been effective demand. The growth of demand is linked to growth of such exogenous elements as government expenditures and world trade.

... and the goal of full employment:

... will be easier to reach if medium-run expected wage growth is strictly contained. We do not know whether, and how, that condition can be met. Under that condition the fear that faster output growth would rekindle inflation is probably misplaced ... And the expansion would require cooperation among several European countries if national current account problems are to remain manageable ...⁴

Two concluding remarks are:

1. Public deficits are more tolerable ... if they correspond to public investments.
2. ... a reduction in labour taxes should be targeted toward the low end of the wage scale.

These two conclusions are also reflected in the proposal by Drèze and Malinvaud (1994) for a two-handed policy to combat unemployment in Europe. It includes “two medium term programs: a drastic reduction of the indirect cost of unskilled labour and an ambitious stimulation of targeted investments” (abstract). This proposal was widely circulated and was publicly supported by Belgian and French leading economists. These proposals are also reflected in the European Union 1993 ‘White Paper on Growth, Competitiveness, and Employment’. However, it did not have a strong impact on European economic policy. According to Dostal (2004: 441):

The White Paper ... represented a flotation of potential policy options, many of which – such as the seemingly ‘Euro-Keynesian’ demand for investment in ‘Trans-European Networks’ – were never properly pursued.

2.2 The NAIRU approach

Layard and Nickell’s work pushed the NAIRU framework into the European academic spotlight and the culmination Layard, Nickell and Jackman (1991) (hereafter LNJ) became the path-setting work that continues to influence European policy making. It was the ‘brains’ behind the OECD (1994) Jobs Study which set the policy agenda for most European and other

OECD countries until today (Dostal, 2004: Section 2). As a consequence it also has had a powerful effect on the EU's European Employment Strategy (Goetschy, 1999; López-Santana, 2003). Finally, it has had a lasting impact on academic research and teaching in Europe.

It is unfortunate that such a flimsy theoretical basis has commanded such uniformity in adherence. Following Friedman (1968), LNJ (1991: 12-13) construct unemployment as arising from the consequences of the battle between mark-ups on wages and prices:

Only if the real wage desired by wage-setters is the same as that desired by price-setters will inflation be stable. *And the variable which brings about this consistency is the level of unemployment.* ... Thus, unemployment is the mechanism which ensures that the claims on national output are compatible ... [thus] ... There is indeed a long-run equilibrium at which both unemployment and inflation will be stable. We call this the long-run NAIRU ... (emphasis in original).

Although they apparently wish to avoid the conclusion that the NAIRU is an inevitable outcome of the economic process, they cannot but help to describe it as “the state to which the system will return after a disturbance” (LNJ, 1991: 9). Moreover, “In the long run, unemployment is entirely determined by long-run supply factors and equals the NAIRU” (LNJ, 1991: 16).

LNJ (1991: 21) seem to suggest that the fundamental results obtained from the New Classical Lucas supply curve is imposed on them – almost against their will: “Although our interpretation of the structural model differs so sharply from the new-classical model, it remains true that the reduced forms are indistinguishable.” Notwithstanding this, they then conclude, somewhat relieved, that “the policy implications of the two approaches are so different”. However, Minford (1993: 1055) in his review of the book comments: “As for policy, it might amaze them, but it is a fact, that there is an overwhelming agreement between at least this New Classical economist and LNJ – for example the need for tougher benefit testing, and for measures to restrict monopoly power”. Ultimately, the policies are not fundamentally different and reflect a construction of the unemployment problem that excludes macroeconomic demand failure and a rigid belief in the NAIRU concept as the ‘attractor’ which is deemed to be invariant to aggregate demand manipulation.

The equilibrium rate of unemployment is influenced by three kinds of factors: (1) anything that shifts the Beveridge curve, in particular search effectiveness; (2) factors which place upward pressure on wages other than unemployment; and (3) any factor which raises prices at a given level of demand. Search effectiveness is central to their analysis through its impact on the notion of voluntary unemployment. LNJ (1991: 11) note:

Even when unemployment is high, there are no queues for all vacancies. There is a secondary sector in the labour market that does more or less clear ... If people are unemployed, it is generally because they have decided against these jobs. They are however willing to work in a range of ‘good’ primary sector jobs, but they cannot get them. In this sense unemployment is both voluntary and involuntary.⁵

LNJ (1991: 34) also stress that the unemployed should be vigorous in their search activity so that “firms can get workers more easily and disemployed people face fiercer competition for jobs. Thus if unemployed seek harder, there need be fewer of them in order to restrain wage pressure.” This leads LNJ to conclude that it is the ‘effective’ unemployed that is the relevant discipline on wage bargaining rather than the actual number of unemployed.

Another implication of their reasoning is that rising long-term unemployment (and reduced search effectiveness) reduces the impact of overall unemployment on wage outcomes. As a consequence LNJ (1991: 10) say “There is however some ‘short-run NAIRU’, which *would* be consistent with stable inflation, and which of course depends on last year’s

unemployment”. Thus hysteresis may play a role. LNJ (1991: 18) say the short-run NAIRU “lies between last period’s unemployment and the long-run NAIRU.” This also implies that “...in the short-run, unemployment is determined by the interaction of aggregate demand and short-run aggregate supply ... [but as LNJ hasten to add] ... In the long run, unemployment is entirely determined by long-run supply factors and equals the NAIRU” (LNJ, 1991: 16).

LNJ have a confused view on the impact of economic policy on unemployment. On the one hand, as noted by Nickell and van Ours (2000: 140), a reasonable interpretation of LNJ is that:

The equilibrium rate of unemployment cannot be changed with fiscal, monetary or exchange rate policy. What these policies can do is change the way actual unemployment fluctuates around the equilibrium rate.

However, LNJ (1991: 13) also observe that “... if financial policy ensures that inflation *is* stable, then unemployment will adjust to its equilibrium level”. The latter observation is reinforced in Nickell and van Ours (2000: 142) when they ask: “Why do we have unemployment?” Basically their answer is that authorities are afraid of generating inflation. A similar divergence in possibilities is observed by Tobin (1996: 326): “...What leads to such [equilibrium]? Some economists would stress the ultimate natural equilibration of markets. Other would stress the response of macro policy makers.” Apparently LNJ alternate between both views.

3. The deficiencies in the NAIRU approach

In Section 3.1, we identify three distinct lines of attack against the notion and use of the NAIRU. In Section 3.2, we illustrate some of these conceptual flaws using empirical data for the Netherlands.

3.1 Three lines of attack

In Mitchell and Muysken (2004) we distinguish three broad lines of attack on the concept of the NAIRU. First, the NAIRU is attacked along theoretical lines, although this literature often uses empirical work to consolidate the argument. Blanchard (1997), Phelps (1994) and Phelps and Zoega (1998) amend the NAIRU model to include costs of capital which enables them to implicate high real interest rates for the European unemployment in the 1980s. Rowthorn (1999) also analyses the impact of productivity shocks. Modigliani (2000) and Sawyer (2002) emphasise the role of aggregate demand in determining the NAIRU (essentially through real interest rate effects). Numerous studies look at the impact of hysteresis (Ball, 1999). Finally Akerlof *et al.* (2000) argue that ‘near-rational behaviour’, which allows for money illusion, causes a trade-off between unemployment and inflation at relatively low rates of inflation, even in the long run. Mitchell and Muysken (2003: 7) conclude in a literature summary “... once deconstructed it is little wonder that the concept of equilibrium unemployment loses its original ‘structural’ meaning and becomes indistinguishable in dynamics from actual unemployment.”

Second, a growing literature has documented the empirical failings of NAIRU models. Campbell and Mankiw (1987, 1989) find non-linearities in the reaction of unemployment to shocks. These findings run contrary to the NAIRU approach which is built on smooth linear functions. Chang (1997) and Fair (2000) demonstrate that inflation dynamics do not seem to accord with those specified in the NAIRU hypothesis. There is no clear correlation between changes in the inflation rate and the level of unemployment, such that inflation rises and falls at many different unemployment rates without system. The time-varying NAIRU approach which replaced the discredited constant NAIRU depiction has been similarly tainted by lack of economic and empirical content (Gordon, 1997). Staiger, Stock and Watson (1997) find

large standard errors for NAIRU estimates which render the concept relatively useless for policy analysis (see below). Baker *et al.* (2002) are highly critical of the NAIRU approach after forensically examining a large number of NAIRU studies. Similar results are obtained from the meta study of Stanley (2004) on hysteresis. Ball (1999) and Modigliani (2000) demonstrate that close relationships exist between employment and vacancies growth and the inverse of the unemployment rate, and between investment to GDP ratios and the unemployment rate across many countries. They are difficult to interpret as being driven from the supply-side.

Third, the usefulness of the NAIRU for policy purposes is also questioned. As a criticism, Galbraith (1997: 106) establishes the primacy of the NAIRU in the neo-liberal policy framework:

One of the serious unintended consequences of economists' preoccupation with the NAIRU has been to convey a message to political leaders that they need not feel responsibility in this area, that the inflation-unemployment trade-off can be fine-tuned with interest rates by the FED.

In assessing whether the NAIRU should have this status, Chang (1997) concludes that:

In practice, the concept of a nonaccelerating inflation rate of unemployment is not useful for policy purposes. First, the NAIRU moves around. Second, uncertainty about where the NAIRU is at any point of time is considerable. Third, even if we knew where the NAIRU were, it would be sub optimal to predict inflation solely on the basis of the comparison of unemployment against the NAIRU. A policy of raising the fed funds rate when unemployment falls below the NAIRU may be ineffective...even if the NAIRU were constant, its location were known and all shocks to the economy were to come from the demand side. Implementing such policy would likely induce changes in the expectations and behaviour of the private sector an important additional reason to be sceptical about using the NAIRU for policy.

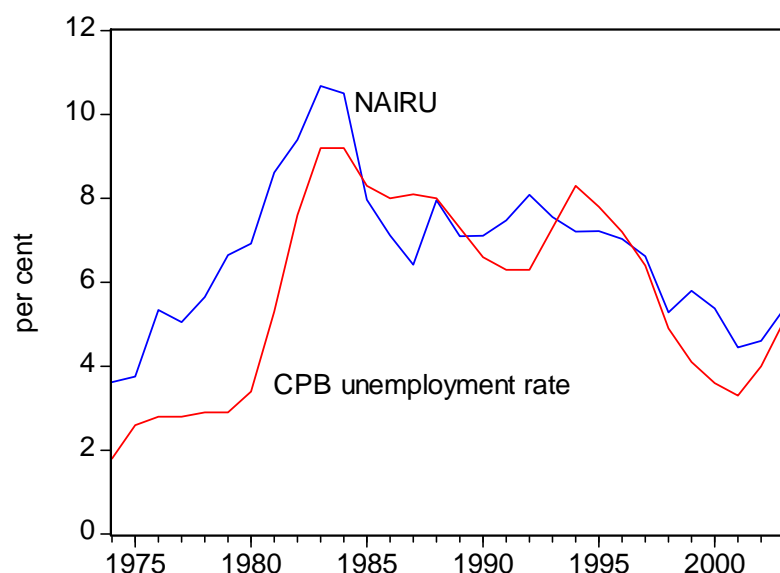
Solow and Taylor (1999) emphasise the dangers inherent in following a NAIRU strategy to control inflation. While there may be stability between inflation and unemployment for a period, a sudden shock, especially from the supply side (as in 1974, for example) can exacerbate the costs of unemployment resulting from a deflationary strategy (which attempts to exploit a given Phillips curve). Evidence from the OECD experience over the last 25 years suggests that this policy is effective in bringing inflation down (Mitchell, 1998; Cornwall, 1983). But rarely are the costs of such a strategy computed or addressed despite the overwhelming evidence that the costs of sustained high unemployment are enormous (Watts and Mitchell, 2000). This is precisely why the Brussels-Frankfurt consensus is an answer to the wrong question.

3.2 The implausibility of the Dutch NAIRU?

The CPB has recently started to publish data on equilibrium unemployment, which is based on their conception and operationalisation of the NAIRU approach. Figure 3 presents CPB's recent data. The behaviour of the NAIRU time series recalls Gordon's (1997: 28) conclusion that:⁶

... wild gyrations of the estimated NAIRU over a range too wide to be explained by microeconomic changes in market structure and institutions would lead to scepticism about the NAIRU concept ... When applied to Europe ... fluctuations in the NAIRU seem too large to be plausible and seem mainly to mimic movements in the actual unemployment rate.

Figure 3 Actual and equilibrium unemployment, The Netherlands, 1974 – 2003



Source: (Verbruggen, 2003, Fig. 4)

The equilibrium unemployment data are consistent with those estimated in Broer *et al.* (2000). Mitchell and Muysken (2003) present strong and diverse criticisms of their approach. First Broer *et al.* concentrate on supply side variables thus ignoring the impact of the demand side on unemployment. We return to that theme below. Second, we show that many of the alleged supply side variables are strongly influenced by cyclical movements. An illustration is given in Table 1 below (see also Mitchell and Muysken, 2003, Table 3).

The Table reports estimates of the wedge (an attempt to measure differences between gross wage costs (borne by employers) and net wage income (received by workers)) and the replacement rate (which purports to measure average social security outlays as a percentage of the average wage). Mitchell and Muysken (2003) show that the data used for these and other variables differ, sometimes considerably, over the various studies used (even amongst CPB related authors). This affects both the estimation results and policy conclusions.

Table 1 Testing wedge and replacement rate variables for cyclical influence

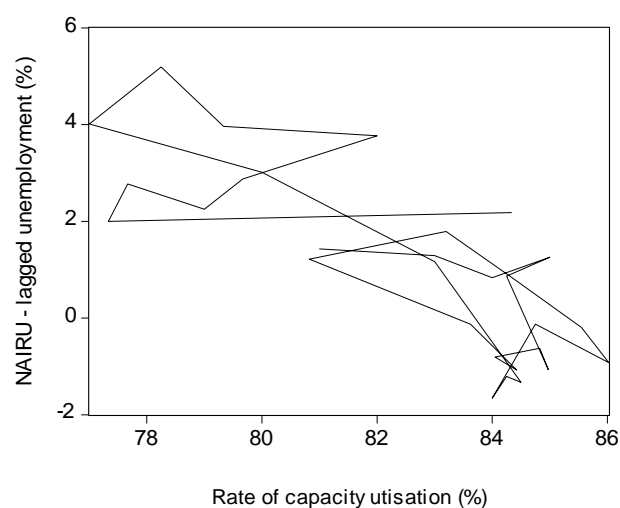
	Replacement Rate		Wedge	
	Broer	CPB	Broer	CPB
dvar(-1)	0.02 (0.21)	0.18 (1.07)	0.20 (1.04)	0.26 (1.55)
dlog(CU)	-0.23 (3.05)	-0.23 (2.97)	0.10 (0.57)	-0.01 (0.06)
dlog (CU(-1))	-0.18 (2.26)	-0.14 (1.64)	-0.39 (2.19)	-0.23 (1.96)
R^2	0.37	0.39	0.19	0.19
Years	1970-1997	1972-2003	1970-1997	1972-2003

Notes: Constant not reported; dependent variables were in change of log form; dvar(-1) is the lagged dependent variable; CU is the rate of capacity utilisation; *t*-statistics are in parentheses. Data is from Broer = Broer *et al* (2000) and CPB = current official data from the CPB.

From Table 1, it is clear that the ‘structural’ variables used by Broer *et al* (2000) and the official CPB measures vary counter-cyclically with capacity utilisation which is consistent with *a priori* reasoning. In the upturn falling unemployment means that lower social security premiums are needed to cover expenses and the wedge will be lower. The replacement rate rises as unemployment rises because there is increasing-pressure to increase social security in a downturn. As a consequence of the counter-cyclical behaviour of these so-called ‘structural’ variables the NAIRU will tend to track the actual unemployment rate in line with demand changes rendering it void of any meaningful independent content.

Our contention that the NAIRU is strongly driven by cyclical movements is also illustrated in Figure 4.⁷ Two comments should be made here. First, one should be aware that hysteresis (tracking of the actual unemployment rate by the estimated NAIRU) plays an important role in explaining the NAIRU, as illustrated in Figure 5. That is, the NAIRU (which may include structural parameters) is dependent on unemployment in the previous period which suggests that structural imbalance is cyclically sensitive. Interestingly, this effect is not modelled by Broer *et al.* (2000, Equation 17) although their results show that hysteresis does occur.

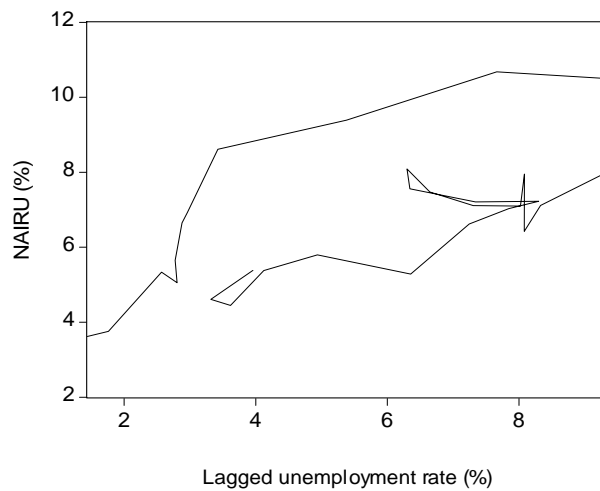
Figure 4 The NAIRU and capacity utilisation, 1974 – 2003



Source: Verbruggen (2003).

Second, given the output gap plays no role in the analysis of Broer *et al.* (2000), we conclude they see no connection between it and the NAIRU. However, Figure 5 shows that when we correct for hysteresis in a very simple way (by subtracting lagged unemployment from the estimated NAIRU) there is a clear relationship between the remaining component of the equilibrium unemployment and capacity utilisation, which implies that cyclical variation plays an important role. This also links the NAIRU to fluctuations in aggregate demand.

Figure 5 Dutch Hysteresis, 1974 – 2003

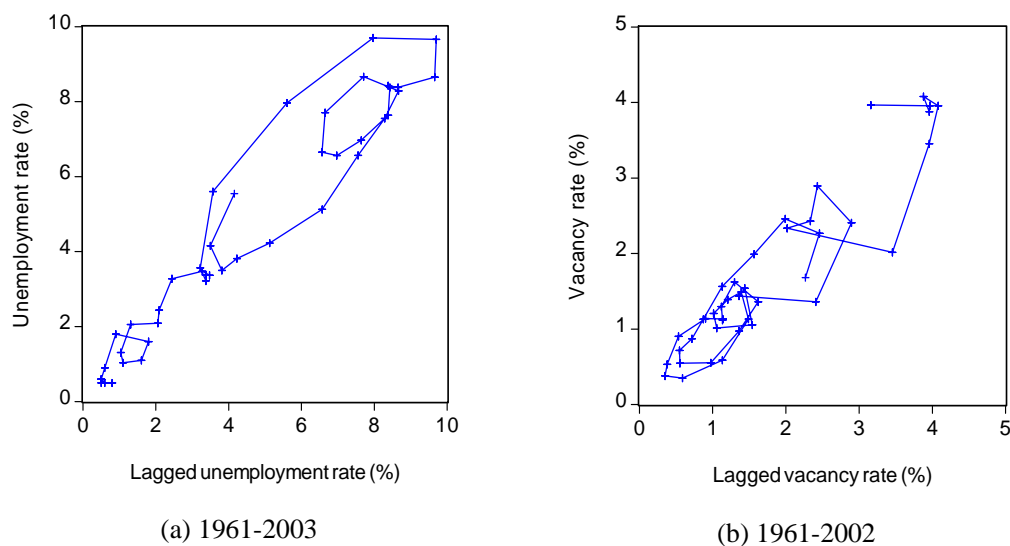


Source: see Figure 4

Given these results it is also not surprising that Mitchell and Muysken (2003) find that the Dutch labour market responds positively to strong GDP growth driving strong employment growth. Thus aggregate demand variations rather than labour force (supply) changes dominate employment changes. Moreover, variations in unemployment appear to be strongly associated with movements in labour demand. This is consistent with Modigliani (2000: 5) who said “Everywhere unemployment has risen because of a large shrinkage in the number of positions needed to satisfy existing demand.”

To analyse the nature of unemployment further, Mitchell and Muysken (2003) present phase diagrams for the unemployment rate and the vacancy rate in the Netherlands (Ormerod, 1994; Mitchell, 2001a). Figure 6, charts the current values of the series are plotted on the y-axis against the lagged value of the same series on the x-axis.

Figure 6 Phase diagrams for unemployment rate and vacancy rate, 1961 - 2003



Source: CPB (2003)

The OECD consensus interprets the outward unemployment shift in Figure 6(a) as a decline in labour market efficiency. But the inward shift in Figure 6(b), using the same logic, would be interpreted as increasing matching efficiency. Clearly, both states cannot hold. A consistent interpretation can be found in the view that the Dutch economy was demand constrained in the mid-1970s as a result of the collapse of the world trade. The rapid rise in unemployment in 1974 was so large that subsequent (lower) growth with on-going labour force and productivity growth could not reverse the stockpile of unemployed (see Mitchell, 2001b for similar Australian analysis).

Two conclusions can be drawn from the phase diagrams. First, negative shifts in attractors coincide with recessions. Second, the economy tends to oscillate around these attractors once they are established. This implies that adverse demand shocks have a strong negative impact on unemployment through hysteresis. Thus demand shocks have an adverse impact on unemployment through the direct effects on job creation, as highlighted in the previous section, and indirectly, through hysteresis.

All these observations serve to cast serious doubts on the notion implied by the Brussels-Frankfurt consensus that combating unemployment should be separated from macroeconomic policy.

4. The OECD Jobs Study and the EES: Two sides of the same coin

Stiglitz (2002: 42) gives a fascinating account of how the IMF has dominated thinking about economic policy in both developed and developing countries. Not only does he strongly criticise the 'one-size-fits-all' nature of the IMF policy prescriptions, but he also observes that:

The IMF is like so many bureaucracies; it has repeatedly sought to extend what it does, beyond the objectives originally assigned to it. As IMF's mission creep brought it outside its core area of competency in macroeconomics, into structural issues such as privatisation, labour markets, pension reforms and so forth ...

Stiglitz (2002) argues that the combination of the IMF's fierce promotion of the current dominant ideology in economics, its simplistic yet well-defined policy framework and its good political contacts in the Western world, renders it a very powerful institution, which often overrides the World Bank in its dealing with poor countries. (Stiglitz is of-course also critical of the World Bank)

Although he does not refer to Stiglitz's experiences, Dostal's (2004) account of how the OECD framed EU welfare and labour market policies reveals striking similarities. Dostal (2004: 441) describes persuasively how the OECD deliberately used the Jobs Study to position itself in the policy debate and was highly successful therein. An important observation is that:

... preparation for the economic and monetary union separated macroeconomic policy making from the agenda of employment policy [in Europe]. ... In stead, liberal labour market theorists explained unemployment as a structural issue arising from over-regulation of the wage labour relationship and over-generous wage replacement payments ...

This is entirely consistent with the NAIRU-approach sketched above (See also Casey, 2004; Watt, 2004).

While the OECD (1994) Jobs Study strategy dominates the European Employment Strategy (EES) there are still differences in the two approaches. Dostal (2004) is correct when he points out that many elements of the Jobs Study have been fully absorbed within the EES, as reflected in the latter's four pillars: employability, entrepreneurship, adaptability and gender

equality. Casey (2004) presents a detailed overview of the similarities between the recommendations of both strategies. Casey (2004: 5) points out that the recommendations reflect a 'structural' interpretation of unemployment, "symptomatic of an insufficient ability to adapt to change ... [implying] ... a focus on policies concerned with labour."

Other authors prefer to stress the differences between the Jobs Study and the EES, which lie, not so much in the underlying analysis, but in the implementation of the recommendations. It is widely recognised that the OECD-recommendations are framed by NAIRU-based beliefs which provide a unified form of discourse,⁸ while the European Union approach is much more eclectic, balancing between various interest groups (Noaksson and Jacobsson, 2003; Dostal, 2004; Casey, 2004). This also is reflected in the so-called open coordination method which is an integral part of the EES, and was introduced at the outset during the Luxembourg process (Goetschy, 1999). Mosher and Trubeck (2003: 83) argue that the open coordination method "has been touted as a third way in EU governance to be used when harmonisation is unworkable but mutual recognition and the resulting regulatory competition may have unwelcome consequences." Key elements of this method include the use of best-practice techniques to encourage learning between units within the EU; benchmarking; consultation; and action plans, the latter which are defined in terms of concrete targets but no attendant punishments for non achievement. Consistent with the 'Third Way' approach, Mosher and Trubeck (2003: 64) observe:

Where some see a creative breakthrough that will solve problems up till now considered intractable, others see another threat to Europe's generous social policies. For the optimists, the EES is not only a methodological breakthrough for the Union, but also an innovation with superior capacity to solve the many social problems Europe faces... Others, however, fear that by moving away from efforts to mandate uniform and social standards, the Union might contribute to the gradual erosion of social programmes and policies.

These differences in approach between the OECD and the EU lead Casey (2004: 19) to conclude that there is "one view of the labour market, but two views of the welfare state."

Finally it is interesting to observe that both the OECD Jobs Strategy and the EES are under revision (OECD, 2004; Watt, 2004). But our expectations of a fundamental change towards a job creation approach are not high! As Watt (2004: 135) observes: "In the wider context of employment policy as a whole, however, the changes ... [in the EES] ... pale into insignificance compared to the short-term threats to employment posed by both by global economic developments and risks, and the inability to reach agreement ... to promote output stability and growth that are needed to bring about a sustained raise in employment." This observation brings us to the Stability and Growth Pact (hereafter the SGP).

5. The Stability and Growth Pact: neither stability nor growth

According to the Maastricht Treaty in 1992, countries that wanted to be included in the Euro zone had to fulfil amongst other things the following two requirements: (a) a debt to GDP ratio below 60 per cent, or converging towards it; and (b) a budget deficit below 3 per cent of GDP. It is now widely recognised that these figures are highly arbitrary without any solid theoretical foundation or internal consistency, although they were consistent with some key empirical situations prevailing at that time. The rationale to control government debt and budget deficits were consistent with the rising neo-liberal orthodoxy that promoted inflation control to be the macroeconomic policy priority and asserted the primacy of monetary policy (a narrow conception notwithstanding) over fiscal policy. Indeed, fiscal policy was forced by this 'inflation-first' ideology to become a passive actor on the macroeconomic stage. Many countries have taken this route in the 1990s including Canada, Australia, New Zealand, the UK, and to a lesser extent the US.

The limitations of this approach in the sense that it renders the unemployment rate a policy instrument rather than a target are aggravated for Europe because the ECB cannot differentiate its monetary policy between European member states. While fiscal policy remains a national affair, the aim was to put it into a straitjacket and hence neuter its effectiveness. The underlying logic of this policy framework, which to us is a nonsensically restricted approach to macroeconomic policy (more about which later), was the perceived danger, articulated in particular by Germany at the inception, that some runaway member states might follow a reckless spending policy, which in its turn would force the ECB to increase its interest rates. Such a policy shift may damage, unjustifiably, the other 'compliant' countries. As a consequence, fiscal constraints should be in place to prevent countries like Italy and Spain from 'spoiling the party' for the rest of the Euro countries. Some party it has turned out to be!

Aided by the growth period following the 1991 recession, the fiscal constraints were met by all aspiring member states. Emboldened by this success, and more alert because the date for the Euro introduction was approaching, the Euro countries decided in the 1997 Amsterdam Treaty that the rules should be sharpened. The deficit should be either zero or in surplus, and when it threatened to reach 3 per cent of GDP, countries should take appropriate measures. This requirement, formalised in the SGP, was criticised by many economists.

Even economists operating from within the relatively orthodox 'deficit dove' paradigm, such as De Grauwe (2003), forcefully argue that there is no rationale for a zero government debt, which a zero deficit should imply in the long run. It is also easy to show that a constant ratio of debt to GDP is sustainable as long as GDP growth exceeds the real interest rate: in that case the deficit can equal the difference between both. That observation illustrates that from this perspective it is much more fruitful to concentrate on stimulating economic growth, than on anxiously guarding government deficits (Fitoussi and Saraceno, 2004). From the 'deficit dove' viewpoint, public borrowing is constructed as a very normal way to 'finance' capital expenditures. Since government invests a lot in infrastructure and other public works, those investments at least should allow for a deficit. This was already recognised by the classical economists as a "golden rule" of public finance – for a modern variant see Buiter and Grafe (2002). In the next section we will criticise the SGP from the perspective of the functional finance paradigm.

Any economist with even the simplest understanding of the way in which automatic stabilisers operate will see the lack of wisdom in the SGP rule. A sharp negative demand shock which causes an economic downturn will reduce tax receipts and increase benefits, which together automatically increases the deficit. Reducing government expenditures in that situation to meet the 'rule' will worsen (prolong) the recession, which will then in all likelihood involve the country in further SGP rule violations. The vicious circle of spending cuts implied is unsustainable and fiscal lunacy. In other words, fiscal policy becomes procyclical under the SGP rule violating any sensible ambitions that are the ambit of responsible fiscal management. This is the major reason that France and Germany have refused to comply with the 3 per cent rule over the last few fiscal years.

Another problem relates to the bias in the way fiscal adjustment is conceived – it is automatically assumed that discretionary actions to reduce the budget deficit will involve spending cuts rather than increasing taxes. We cannot help but have the impression that some politicians are not primarily concerned about the size of the budget deficit, but covet the 3 per cent rule as a welcome excuse to be forced their preferences for 'small government'. In other words, the ideological bias against public activity, particularly in the social security sphere is dressed up as 'prudential economic management'.

This obsession is even more problematic when one considers that monetary policy is in the hands of the ECB, which is not politically responsible for its actions: it is independent, and its sole aim is to control inflation. The fundamental democratic principle that the citizens have the ability to cast judgement on the policies of their representatives at regular intervals has been abandoned in this setup.

Stiglitz (2002: 45) is highly critical of the EU model:

There is a wide-spread feeling that Europe's independent Central Bank exacerbated Europe's economic slowdown in 2001, as, like a child, it responded peevishly to the natural political concerns over growing unemployment. Just to show that it was independent, it refused to allow the interest rates to fall, and there was nothing anyone could do about it. The problems partly arose because the European Central Bank has a mandate to focus on inflation, a policy ... that can stifle growth or exacerbate an economic down turn.

The straitjacket that the ECB has voluntarily placed itself in suggests that countries have to use fiscal policy to react to economic shocks which affect the real economy. However, the SGP has imposed an inflexibility on this discretion and stagnant economic outcomes have been the norm (see also Bofinger, 2003; Arestis and Sawyer, 2004).

It is often said that the European economies are sclerotic, which is usually taken to mean they have too much labour market protections and overly generous welfare systems. However, the real European sclerosis is found in the inflexible macroeconomic policy regime that the Euro countries have voluntarily contrived. The rigid monetary arrangements conducted by the 'undemocratic' ECB and the irrational fiscal constraints that are required if the SGP is to be adhered to, render the nation states within the Eurozone incapable of achieving low levels of unemployment and increasing income growth. These observations then lead to our more embracing criticism of the Brussels-Frankfurt consensus from the perspective of the functional finance paradigm.

6. The Brussels-Frankfurt consensus and functional finance

The European economies are in melt down because their leaders have misunderstood the options open to them under conditions of sovereign currency. The principles of functional finance (Mitchell, 1998; Wray, 1998; Mitchell and Mosler, 2002) describe these options and prescribe how macroeconomic policy instruments should be used to achieve them. In this section, we provide a brief introduction.

There has been a lot of concern about the strong Euro in recent years relative to the \$US. The answer is illustrative of what is wrong with the European economies. National accounting tells us that Government deficits are equal to non-governmental savings which in this context are defined as Euro-denominated financial assets. Without loss of generality, the non governmental sector is comprised of the private domestic sector and the foreign sector. As a matter of accounting, government deficits are the sum of domestic savings plus foreign savings. The private sector savings can be sourced from the public deficit or from the foreign sector. In our view, in recent years there has been a shortage of Euros in the foreign sector and a lack of desire by foreigners to take on Euro-denominated debt. Thus for the private domestic sector to accumulate Euro savings the government sector has to be ready to provide the funds. Unfortunately, by design, the sovereign governments in Europe have voluntarily constrained their ability to run discretionary deficits which are essential to meet desired domestic savings targets.

The link between the fact that private domestic participants in Europe are unable to achieve their desired net savings of euro denominated financial assets and the persistent unemployment and wasteful excess capacity is clear. To resolve the impasse there has to be

more Euro-denominated spending to challenge inventories and provide incentives for European producers to expand production and employment. The malaise occurs because in an attempt to net save when there is insufficient public deficit injection, the private sector cuts back spending. The dilemma is the classic macroeconomic compositional fallacy (the so-called paradox of saving) – by trying to save when there is insufficient public spending the private sector merely exacerbates the problem and achieves lower actual savings.

The persistent weakness of European labour markets is symptomatic of their slack product markets and policy makers have constructed this malaise in exactly the wrong way. Given the overwhelming dominance of the neo-liberal disdain for fiscal activism, there has been a major shift in the aggregate policy mix towards the centrality of monetary policy under the guise of ‘fight-inflation’. The imagery that comes to mind is of a pugilist who goes into fight with one hand tied behind his/her back. Not a clever strategy. It appears that European policy makers think that lower interest rates (given the monetary policy emphasis) is the only acceptable aggregate policy response to the economic melt-down.

They should think again. If the problem truly is that the private sector are being squeezed relative to their desire to accumulate net savings in Euro-denominated financial assets then interest rates do nothing for this. Only net government spending will provide the ‘vertical’ liquidity injection to achieve to underpin the desired private credit structure.

The policy makers clearly are hoping that lower interest rates will stifle the desire to save and hence consumers and investors will be induced to increase their leverage levels which would underpin a spending recovery. This is a fraught strategy. First, the ECB has artificially constrained itself to CPI rules although it is debated whether the CPI measures anything that is relevant for reflecting price pressure. These constraints are just neo-liberal dogma with little economic content to justify them. If deficits were inflationary, how do the European economists who support the current system explain the situation in Japan or in the US?

Second, the Japanese situation is worth reflecting on. It is unclear that lower interest rates will stimulate demand. It relies on a number of dubious distributional assumptions that have not been substantiated by any credible research. Japan has been running excess reserves in their banking system for years as a result of the public net injection not being fully ‘drained’ by Bank of Japan bond sales. The result of this deliberate practice has been interest rates of around 0.001 per cent for over a decade. There has been very little spending reaction to the low rates and further the Yen remains strong.

The solution to the high unemployment in Europe that we advocate in this paper is however rejected by ill-informed policy makers. The attack on the unemployment problem should be on two broad fronts. First, the artificial and damaging constraints on fiscal policy under the GSP have to be abandoned and governments should increase their deficit spending to be at least within the range of 5 per cent of GDP until recovery ensures. This level of net spending will underpin the desire to save and create solid demand for inventories which in turn will promote employment growth. It is hard to see this as an inflationary act given the massive excess labour and capital resources that abound right across Europe.⁹ The defiant trend demonstrated by Germany and France in recent fiscal years should be generalised. As part of this generalised liquidity expansion European governments should also introduce an unconditional job offer to any person who is unable to find work. This offer should not chase market wages but should instead be at the minimum living wage. This policy approach – termed a Job Guarantee by Mitchell (1998) will secure full employment without invoking demand pressures. Indeed, as Mitchell and Wray (2005) argue it could be introduced at a time of demand contraction and still ensure full employment existed. There is simply no economic reason why workers who are being supported in the public sector on welfare should not be

provided with an opportunity to productively contribute to their societies by working. The only thing preventing this is the will of European governments to provide these jobs. For a full recent exposition of the Job Guarantee see Mitchell and Wray (2005). Whatever else the governments do by way of spending, they should always have this 'buffer stock' of jobs available. It is far better from a resource usage and social benefit perspective to fight inflation with a buffer stock of jobs than it is to use a buffer stock of unemployment (zero output) which is the NAIRU and hence the Consensus approach.

The second policy front that should be opened is to return to the strategy that made Germany one of the world powerhouse economies in the past. At the same time that domestic labour and capital resources have been underutilised, European export growth, which previously were the 'back-bone' of the various economies have stalled. A major part in this slowdown has been the rise in the value of the Euro rather than soft world product markets. So what has been the problem? Take the German case before the monetary union was formalised. During that period the Bundesbank always bought enough \$US to keep the Mark from appreciating to such a level that the German exporters would be damaged. The German consumer thus, in part, 'cross-subsidised' the strong GDP growth and fully employed labour force.

If the European governments are intent on maintaining unreasonably tight fiscal policy then their export markets will have to provide the engine of growth. Even with a modest recovery in world product markets the ECB has to start purchasing large quantities of foreign currency to underpin the export sector. The problem is not only that there has been a concentration on monetary policy at the expense of the fiscal activism but also that the concept of monetary intervention has also been re-defined by the neo-liberal ideologues. It is an essential part of a sophisticated monetary policy for the central bank to directly intervene in currency markets and in this case for the ECB to start accumulating \$US reserves.

The conduct of the Bank of Japan is again illustrative. It is a large purchaser of \$US which allows it to net spend in terms of the Yen. The same applies to the ECB. By purchasing \$US on foreign currency markets it net spends in the Euro and drives up the net Euro-denominated savings of the non-government sector. It should be noted that we consider the treasury and the central bank operations to be consolidated when we talk about the public or government deficit relative to the non-government balance.

The other advantage of this strategy would be that it would allow the ECB to maintain Euro parity at rates supportive of the European exporters.¹⁰ The explanation as it has abandoned another of its aggregate policy arms. The answer is simple – ideology has forced it into a treaty that has little economic justification. The ECB would clearly consider such a strategy unacceptable because it would appear that the \$US was being employed as the reserve currency for the Euro. Given the history of the Euro and the bellicose intentions of the European central banking mandarins that the new currency should rival the \$US as the world's reserve currency, this appearance would strike horror.

But the current position is not sustainable. An export growth strategy not supported by central bank currency market interventions means that the export profits find their way into Euros which drives the parity higher and undermines the export strategy.

The only strategy left open to European firms facing slowing demand for their export products as a result of this insane policy environment is to cut costs in general to restore profit targets.¹¹ The casualties are the workers who enter the labour queues and the multiplier effects then generate further income losses and softening domestic product market conditions.

It should be noted that if the ECB wants to promote the Euro as a 'rival reserve currency' to the \$US there is one essential precondition. Foreigners must be able to 'net save in Euro

denominated financial assets'. But due to inadequate export levels emanating from Europe and a failure of the ECB to use all of its monetary policy instruments this precondition is absent. The solution is for European governments to introduce policies that will stimulate import demand which allows foreigners to accumulate Euro denominated savings. The increased net public spending would certainly help in that regard.

Conclusion

In our view the obsession with low inflation, as reflected in the Brussels-Frankfurt consensus is an answer to the wrong question because it ignores the huge economic and social costs imposed on European countries by the persistently high unemployment. Unfortunately, this malaise is not considered by EU politics to be a major issue that need to be solved with the highest priority. Sadly, it is the other way around: Unemployment, at best, is seen as an unfortunate consequence of the need to maintain a low inflation environment and is a symptom of rigidities which hamper a proper functioning of the economy. At worst, it is seen as a voluntary state where individuals choose life paths emphasising leisure. Never is it constructed as the systematic macroeconomic failure of governments to ensure there are enough jobs created in their economies.

We have argued that the NAIRU-approach and the Brussels-Frankfurt consensus, which underlie this policy position, gained their influence on European policy through the OECD Jobs Study, the European Employment Study, the Maastricht criteria and the Stability and Growth Pact. However, the approach is not based on a correct interpretation of the options facing sovereign governments with monopolies in currency issue and the empirical evidence suggests it is a degenerative paradigm. As such the NAIRU concept provides a poor guide to employment policy. Similar arguments are presented against the Brussels-Frankfurt consensus, where we pay special attention to the Stability and Growth Pact. Using insights from functional finance, we argue that the Pact essentially results in neither stability, nor growth and is, ultimately, unsustainable.

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² In both cases we use unweighted averages.

³ In his sympathetic but critical review of the various efforts in the same volume Blanchard (1990: 66) says: "I am afraid that the research programme may have been overambitious. ... Although much is learned, the very richness of the model makes it harder to see how the model can ... explain what I see as the crucial issue, the persistence of high unemployment."

⁴ In this context the role of responsible unions is emphasised. Drèze and Bean (1990: 22) note that: "in contrast to the United States, wage formation in Europe today is dominated by unions who are greatly concerned about

distributional fairness.” As a consequence Drèze and Bean (1990: 288) argue that “the mechanism through which unemployment could be self-correcting is weak. We should not be surprised that in Europe unemployment has been persistent.”(38).

⁵ Interestingly enough LNJ (1991: 44) abandon this line of thought in the next sentence, stating “But in order to understand how the economy changes over time, it may be good enough to proceed as though there were only one sector, whose wages and employment are determined by the kinds of mechanisms discussed in [the battle between mark ups].” Moreover, if one considers for one moment the high incidence of unemployment amongst the disadvantaged groups, it is obvious that this primary/secondary story does not hold for them. LNJ (1991: 44) also add: “It is however extremely difficult to distinguish between the primary and the secondary sector in the official statistics. The secondary sector is also a fairly small part of the manual labour market.”(44)

⁶ Although they do not refer to this statement, Broer *et al* (2000: 364) response to the broad point of a fluctuating NAIRU is: “The equilibrium rate is only stable insofar as its underlying determinants are stable. Indeed, the concept of a slowly-moving NAIRU, that forms the backbone of much recent work on inflation forecasting in the US (see e.g. Gordon, 1997), is void of empirical content in times of rapid changes in the structural determinants of equilibrium unemployment.”

⁷ The CPB conclusion that “because of the persistent low GDP-growth, the output gap ... has widened sharply in the last few years ... The main reason why the current output gap is even worse than during the early 1980s recession is that at present the unemployment rate exceeds the estimated non-accelerating rate of inflation rate of unemployment (NAIRU), while it did not so in the early 1980s ... In structural terms the labour market is in much better shape now” (Verbruggen, 2003: 11) seems rather bizarre to us. The causality obviously is the other way around!

⁸ In this context we cannot resist the following citation, where Stiglitz (2002: 24) critiques the IMF: “One should not see unemployment just as a statistic, and economic “body count”, the unintended causalities in the fight against inflation ... The unemployed are people, with families whose lives are affected – sometimes devastated – by the economic policies that outsiders recommend ... [or] ...effectively impose. Modern high-tech warfare is designed to remove physical contact: dropping bombs from 50,000 feet ensures that one does not “feel” what one does. Modern economic management is similar: from one’s luxury hotel, one can callously impose policies about which one would think twice if one knew the people whose lives one was destroying.”

⁹ This excess capacity is also observed in the most recent Economic outlook of the OECD, released November 2005, where they predict that the recovery which seemed to be ‘just around the corner’ will be delayed by one year. See also Note 7 above for the case of the Netherlands.

¹⁰ This is the reason why de Grauwe has also advocated this strategy the Financial Times of November 30, 2005.

¹¹ Essentially this is also the policy followed by the Dutch Central Bank in the mid-eighties when it tied the Dutch Guilder to the Deutschmark, essentially enforcing wage moderation. On the one hand this explains the enormous employment growth, the so-called Dutch miracle. However, one of the prices that has been paid for this success was the high incidence of allegedly disabled workers, who have now become an entrenched problem and constitute about 10 per cent of the workforce (Muysken, 2003).